

ISSUE DATE: July 20, 2000

DOCKET NO. E-002/CI-00-415

ORDER REQUIRING PARTIES TO MEET AND FILE A REPORT OR UPDATE WITHIN 45
DAYS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott
Edward A. Garvey
Joel Jacobs
Marshall Johnson
LeRoy Koppendrayer

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of a Request for Investigation of
Northern States Power Company's Practices
Regarding Energy Marketing and the Fuel
Clause

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PROCEDURAL HISTORY

On April 3, 2000, the Residential and Small Business Utilities Division of the Office of Attorney General (OAG) filed a request that the Commission initiate a summary investigation under Minn.Stat. § 216B.21 into Northern States Power Company's (NSP) automatic adjustment of its electric rates. The purpose of the investigation would be to determine whether NSP's practices related to costs included in its retail electric fuel adjustment clause and costs assigned to wholesale electric sales result in a rate that is just and reasonable.

On April 7, 2000, the Commission requested comments on this issue.

On April 27, 2000, comments were received from Minnesota Power, Dakota Electric, Legal Services Advocacy Project, Department of Commerce, Northern States Power, Office of Attorney General and Otter Tail Power.

On May 9, 2000 reply comments were received from Minnesota Power.

On May 10, 2000 reply comments were received from the Office of Attorney General and Northern States Power.

On June 22, 2000 this matter came before the Commission.

FINDINGS AND CONCLUSIONS

I. The Proposed Investigation

The OAG requested that the Commission initiate a summary investigation to determine whether NSP's practices related to costs included in its retail electric fuel adjustment clause and the costs assigned to wholesale electric sales result in a rate that is just and reasonable. The OAG was concerned that as the wholesale markets become more lucrative and electric costs more volatile, incentives may be great for an electric utility to direct its lower-cost production to the wholesale market while passing higher-cost purchases to the ratepayer through the automatic electric fuel adjustment clause.

The Commission requested comments addressing several issues. Each of the issues and the positions of the various parties will be set forth below.

II. The Need for an Investigation of NSP's Practices

A. OAG's Position

The OAG argued that an investigation was needed to determine whether NSP was using the fuel clause properly. The OAG was concerned that NSP may deviate from its commitment to devote its low-cost resources for the benefit of its retail customers. Because of the higher prices available in the summer wholesale market, compared to NSP's lower cost of production, there was a financial incentive to sell the low-cost power on the wholesale market instead of using that low-cost power to serve its retail customers.

The major concern was the potential for NSP to buy extra high-cost power on the wholesale market for the retail market thereby freeing up low-cost NSP resources to sell into the high-priced wholesale market. If NSP were then to recover the costs of the wholesale purchase from its retail customers through the fuel clause it would realize profits from the difference between the actual costs of producing power and the wholesale sale price. The OAG believed that such profits could amount to several million dollars in a single day.

The OAG indicated that NSP filed to recover over \$32 million through the fuel clause for July of 1999. The OAG requested information from NSP to determine if such recovery was reasonable. The OAG's concern arose from the responses received from NSP. The OAG indicated the following factors were of concern:

Since the NSP Energy Marketing division handles such functions as generation dispatch, purchasing, sales and allocation of resources between wholesale and retail customers, there may be an opportunity to coordinate shifting of low cost power from the retail market to the wholesale market;

Employees in the Energy Marketing division are on an incentive pay plan that could

reward them for carrying out such practices;

NSP does not have a formal written policy to prevent such practices;

NSP was unable to supply key information that would allow the OAG to determine whether NSP was selling its low cost power on the wholesale market instead of using it to serve retail customers.

B. NSP's Comments

NSP indicated that no investigation was necessary. The OAG has not come forth with any specific allegation of inappropriate behavior by NSP. The OAG's investigation would be extraordinarily complex, burdensome and expensive and should not be undertaken on the basis of speculation alone.

NSP is willing to work with the OAG and any other party seeking information about the fuel clause at NSP.

An investigation would be duplicative of the Commission's existing procedures of reviewing purchasing and fuel clause accounting practices. NSP makes monthly fuel clause filings which are reviewed by the DOC. NSP files an annual automatic adjustment report with the Commission which is also reviewed by the DOC. These comprehensive reviews do not need to be duplicated. The next NSP electric Annual Automatic Adjustment of Charges report, covering the period July 1999 to June 2000, will be submitted in September 2000. A separate, virtually contemporaneous investigation of NSP's Fuel Clause Adjustment would be duplicative.

NSP did not necessarily disagree with some of the fundamental policy issues raised by the OAG. It agreed that over the last decade the electric industry has changed substantially, wholesale markets have been restructured and become increasingly competitive, and retail demand has continued to grow while supply has been increasingly constrained. NSP suggested that it may be appropriate to consider whether traditional tools such as the fuel clause adjustment continue to produce the desired results. However, such a review of, or changes to, the Commission's fuel clause policies or rules are more appropriate for a separate proceeding where all jurisdictional Minnesota electric utilities and other interested parties can participate.

NSP indicated that having some NSP generation allocated to wholesale during periods when NSP purchased more expensive power was not necessarily evidence of wrongdoing. Reasons that this may occur include NSP's obligation to maintain spinning power and other reserves, NSP's need to back up wind power purchases, variation in unit outages during the day could lead to power for sale, plant efficiency could affect generation costs, and forward purchases could be at prices higher or lower than market at the time energy is scheduled leading to circumstances where such purchases may exceed the cost of generation allocated to wholesale. NSP further indicated that the average generation cost assigned to retail load was about one-half the cost assigned to wholesale. The average cost of generation assigned to retail load during the

peak hours of the July 29 and July 30, 1999 heat storm was about one-third the cost assigned to wholesale. During the peak hours, more than 95% of NSP's generation resources available were assigned to serve retail load, with most of the remainder held in reserves under MAPP.

C. DOC's Comments

The DOC recommended that no investigation be ordered and concluded that NSP has reasonable policies, procedures and controls in place to insure allocation of the lowest cost power supply to residential customers.

The DOC indicated that NSP is experiencing tight purchasing margins which requires purchases in periods of high temperatures. This would indicate that NSP does not have the opportunity to sell power outside normal commitments. On July 29 and 30, 1999, NSP identified plant outages of about 300 MW, causing NSP to buy at market.

D. Comments of Minnesota Power, Otter Tail Power and Dakota Electric

Otter Tail Power and Dakota Electric did not comment on the need to investigate NSP.

Minnesota Power suggested that the analysis by the DOC and NSP's credible response support the conclusion that no further investigation of NSP's fuel clause activity is necessary.

E. Comments of Legal Services Advocacy Project

The Legal Services Advocacy Project recommended an investigation be made into NSP's treatment of costs and wholesale sales as related to the fuel clause. It argued that the OAG made a strong case that incentives exist for misuse.

III. What Should Be the Scope of Any Investigation

A. Comments of the OAG

The OAG recommended an immediate investigation to determine whether, to what extent, and how high-cost wholesale purchases were being charged to retail customers via the fuel clause to enhance the profitability of wholesale sales.

Fuel clause misuse could take place if NSP bought power for retail customers in certain hours that was more expensive than the generation it allocated to wholesale sales in the same hours. The OAG argued that misuse could be identified by examining the hours in which NSP Energy Marketing created margins or profits for NSP. Misuse would be shown if, in any of those hours, the cost of NSP's own generation allocated to wholesale sales was less than the purchased power costs recovered from retail customers through the fuel clause.

The OAG recommended that the investigation address marketing hours where margins were made selling power at a price higher than the cost assigned to the sale, and fuel clause recovery for the costs of power purchases took place. The OAG indicated that data from approximately 4,380

hours in the summer of 1999 would be involved.

The OAG indicated that a limited investigation would be unlikely to uncover and remedy any fuel clause misuse.

B. Comments of NSP

NSP argues that a separate investigation is not warranted but if further review was required it should be in the form of a “spot check” audit. NSP indicated its willingness to work with the Commission, the DOC or the OAG in a more limited review and suggested that an audit of hours where significant wholesale margins were made could be considered reasonable.

C. Comments of the DOC

Although the DOC did not recommend an investigation as necessary, the DOC did suggest that if an investigation were ordered that it be focused on July 29 and 30, 1999 plus two other days chosen at random.

IV. Should an Investigation be Limited to NSP or Expanded to all Minnesota Jurisdiction Electric Utilities

A. Comments of the OAG

The investigation should be limited to NSP, at least initially.

B. Comments of NSP

NSP argued that if an investigation is directed, policy issues would be more appropriately addressed in a generic proceeding where all stakeholders could express their views.

C. Comments of the DOC

Due to differing circumstances, the issue raised by the OAG may not apply to other utilities. If, however, the scope of the investigation were to focus on general policies, practices and controls of the fuel clause, it may be useful to include all Minnesota jurisdictional electric utilities.

D. Comments of Minnesota Power, Otter Tail Power, Dakota Electric and Legal Services Advocacy Project

Each of the utilities agreed that the investigation should be limited to NSP. Legal Services also agreed that at first the investigation should be limited to NSP but suggested it could be expanded at a later date if necessary.

V. Should the Investigation be Broadened to Include Other Considerations

A. Comments of the OAG

Consideration of remedying or mitigating any problem should be done after there is a

determination that there is a problem.

B. Comments of NSP

NSP reiterated its willingness to participate in a generic discussion of potential regulatory reforms which would provide incentives to align ratepayer and shareholder interests and improve the allocation of risk.

C. Comments of DOC

The DOC suggested alternatives to address specific concerns but did not recommend immediate implementation. The DOC indicated support for performance-based regulation. The DOC cautioned that the elimination of the fuel clause at this time could have ramifications and unintended effects under the merger stipulations, where it was presumed that the fuel clause would continue during the rate freeze.

VI. Commission Action

The Commission recognizes, and is aware that most of the parties acknowledge, that energy markets have changed, becoming increasingly more volatile, and that there may be increased opportunities to game the system. It is also evident that the record before the Commission does not reflect any specific allegation of wrongdoing. The Company has, however, indicated its willingness to work with the OAG and other parties to resolve the concerns raised. Therefore, the Commission will order the parties to meet and work together to do so. The Commission will further order that the parties file a report or update with the Commission as directed in the Ordering paragraph, below.

ORDER

1. NSP shall meet with the OAG, the DOC and other parties to work together to resolve the concerns raised by the OAG.
2. The parties shall file a report or update with the Commission within 45 days from the date of this Order. The report shall include suggestions to improve monthly reporting to allow more effective monitoring of allocations to wholesale sales.
3. The parties shall have 30 days from the filing of the report or update to comment.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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